CONSUMER PROTECTION

The Problem with Price Gouging Laws

Is optimal pricing during an emergency unethical?

BY MICHAEL GIBERSON | *Texas Tech University*

The summer of 2008 challenged gasoline retailers. Crude oil prices had climbed to unprecedented heights over the first half of the year, peaking in July before tumbling sharply afterward. Partly in response to the high prices, crude oil and petroleum product inventories were at unusually low levels as the hurricane season began. In late August, Hurricane Gustav tore through the middle of the oil-producing region in the Gulf of Mexico. More than 95 percent of offshore oil and gas platforms were shut down before the storm arrived. Less than two weeks after Gustav, Hurricane Ike threatened another direct hit to the Gulf region's energy production facilities.

Weigle's, a chain of convenience stores in the Knoxville, TN area, was having a hard time finding gasoline supplies after Gustav. According to contemporary news reports, the approach of Ike turned the situation from difficult to nearly impossible. Weigle's buyers typically bought wholesale gasoline in spot markets rather than through long-term contracts. The strategy paid off in slightly lower costs most of the time, helping the stores keep their retail gasoline prices low. The catch is, when wholesale supplies get tight, spot prices can really jump.

On Thursday, two days before Ike made landfall on the Texas coast, owner Bill Weigle said his wholesale costs increased by 85 cents per gallon — and that was when he could find gasoline to buy. The storage tanks that usually served Knoxville were dry and Weigle's had to have whatever gasoline they could find trucked in from other cities. Some of his stores had run out of gasoline, too. He told reporters that "his stores may have to increase prices at the pump by $0.85 to $1 by Friday." The next morning, Weigle's raised prices for regular-grade gasoline at several stores by about 80 cents, from an average near $3.70 per gallon to about $4.50 per gallon.

Pilot Travel Centers, a Knoxville-based national chain, and other area gasoline retailers found themselves in the same general condition. More than one area Pilot station sold gasoline for as much as $4.99 per gallon the weekend that Ike came ashore. Gasoline prices spiked almost everywhere in the country because of the two storms, but the spike was sharpest in Knoxville. During Hurricane Ike's weekend, the Knoxville area had the highest gasoline prices in the United States.

On the Friday that Weigle's and other retailers were raising retail prices, Tennessee's attorney general, Bob Cooper, issued a statement reminding Tennesseans that the state remained under a declared state of emergency. Cooper warned consumers to be on the lookout for price gouging and invited them to report suspected incidents of it. Even before the statement, price complaints were being received by the state. Many more calls came in over the next several days. Overall, Tennessee received more that 4,000 price complaints during the emergency period.

The Tennessee attorney general's office and the state's Department of Commerce and Insurance examined the complaints and launched investigations into the prices charged by 17 gasoline retailers in the state. Seven months after Hurricane Ike struck the Gulf Coast, the state announced that 16 of the 17 companies

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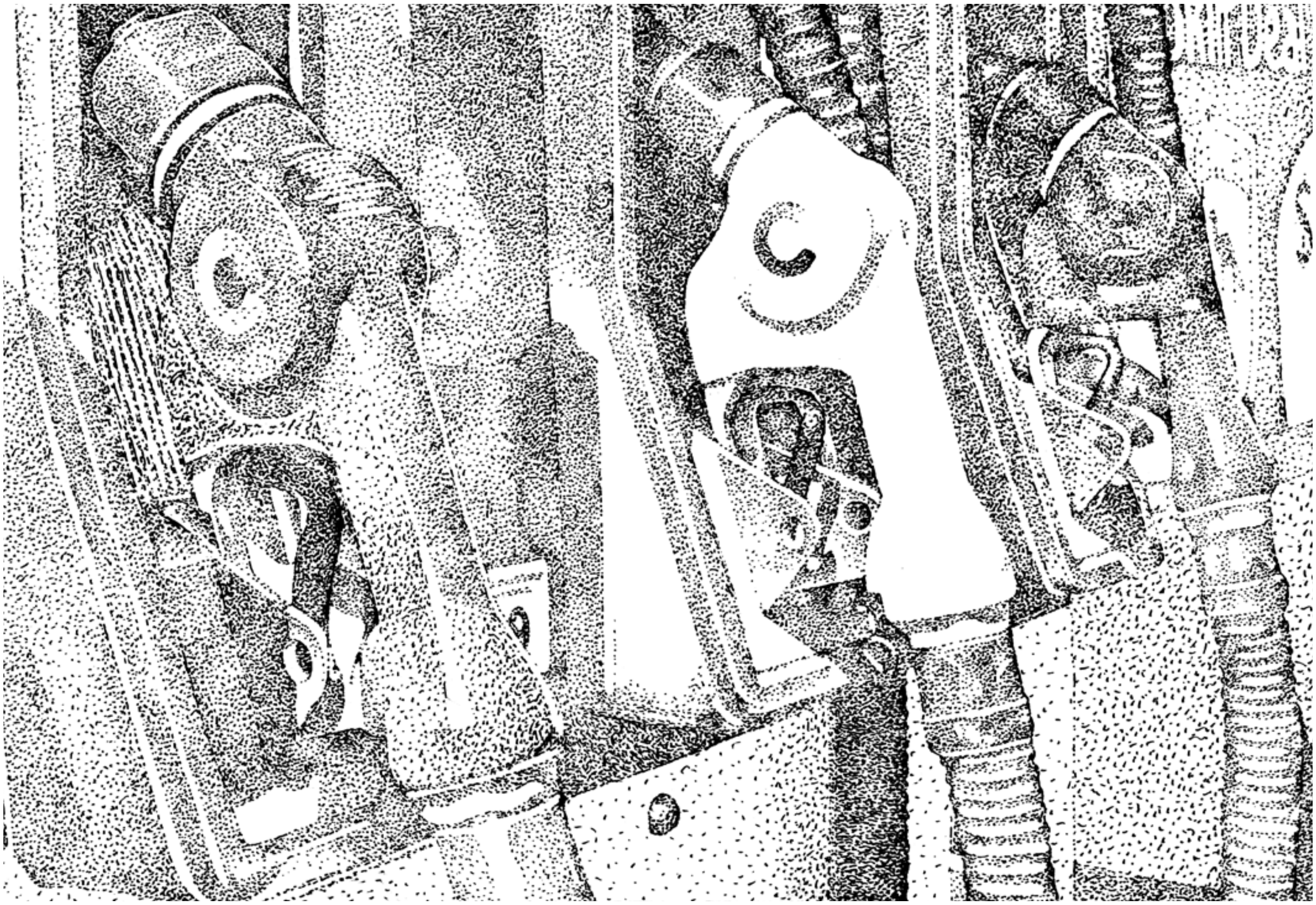

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had entered into settlements. The companies denied wrongdoing but agreed to pay civil penalties and offer refunds. The attorney general's office filed suit against the one company that refused to settle, Weigle's. A year later, Weigle's also settled, agreeing to make $57,000 in payments to the state and offering consumer refunds. As had many of the parties that settled a year sooner, Weigle's denied wrongdoing and said it settled only to avoid the costs and risks inherent in protracted litigation with the state.

Gasoline retailers are not the only targets of price gouging laws. Prices charged on everything from hotel rooms, to electric generators, to bottled water have been occasions for legal action. Duke University economist Michael Munger reported that after Hurricane Fran hit central North Carolina in 1996, four men selling ice were arrested near Raleigh for charging a price much higher than the $1.75 per bag price that prevailed in the area before the storm. Munger said some consumers were angered by the price, but almost no one refused to pay. After all, without power and unsure when the power would return, ice was much more valuable to the consumers than it had been just before the storm.

The price gouging laws of Tennessee and North Carolina, and those of the 30 or so other states with similar laws on the books, are something of a puzzle for economists. Economists usually point to public goods or special interests as the mobilizing force behind regulations. Price controls, including price gouging laws, almost certainly reduce overall economic welfare. And while price controls sometimes create the concentrated benefits sought by interest groups, the benefits and costs of price gouging laws are widely dispersed and uncertain in impact — hardly the kind of prize lobbyists usually pursue.

Instead, price gouging laws appear more akin to laws banning the sale of horse meat for human consumption, "Blue laws" that prevent the sale of certain items on Sunday, or laws that once prohibited interracial marriage. The laws put the force of government behind efforts to prevent people from entering into agreements or transactions that lawmakers find objectionable. One more puzzle: unlike Blue laws and interracial marriage bans, laws against price gouging are not fading away as society becomes more accepting of personal differences. Instead, price gouging laws emerged relatively recently, are spreading geographically, have become more expansive in scope, and are becoming more frequently invoked.

Economists and policy analysts opposed to price gouging laws have relied on the simple logic of price controls: if you cap price increases during an emergency, you discourage conservation of needed goods at exactly the time they are in high demand. Simultaneously, price caps discourage extraordinary supply efforts that would help bring goods in high demand into the affected area. In a classic case of unintended consequences, the law harms the very people whom lawmakers intend to help. The logic of supply and demand, so clear to economists, has had little effect on price gouging policies.

Price Gouging Laws

In popular usage, consumers complain about "price gouging" just about anytime they do not like a price. A casual scan of letters to the editor and online columnists will reveal price gouging claims for everything from 3-D movie tickets, to fresh-cut flowers, to cables for high-definition televisions. Recently, when gasoline prices in Alaska trended up over several months to 40 or 50 cents per gallon above the national average, state legislators charged that refiners were price gouging.

More typically, however, "price gouging" claims involve three factors:

- a price deemed unfairly high,
- an emergency or difficult situation, and
- a product or service useful in responding to the emergency.

Price gouging laws can be more restrictive, sometimes defining one or more of the three factors more clearly:

- a price increase in excess of some threshold,
- a declared state of emergency, and
- a specific set of necessary or useful products or services.

In California, for example, the price gouging law prohibits charging a price more than 10 percent higher than the price charged prior to a declared state of emergency for consumer food items, goods and services used for emergency cleanup, medical supplies, home heating oil and gasoline, and other goods and services in particular demand in post-emergency situations. Many state laws permit retailers to pass along higher wholesale costs while price gouging laws are in effect, so long as the retailer's margin does not increase.

The first state law explicitly directed at price gouging was enacted in New York in 1979, in response to increases in home heating oil prices during the winter of 1978–1979. New York's law initially applied to retailers offering "consumer goods and services vital and necessary for the health, safety, and welfare of consumers" at an "unconscionably excessive price," and applied during an emergency declared by the governor. Just three states passed similar laws in the 1980s: Hawaii in 1983, and Connecticut and Mississippi in 1986. Then, 11 more states added anti-price gouging laws or regulations in the 1990s and 16 states followed in the 2000s.

When price gouging laws are revised, the tendency is for the scope of the law to be broadened, the penalties to become more punitive, and the conditions under which the laws are applied to become less restrictive. The New York law was amended in 1995 to include repairs made on an emergency basis and to increase the maximum fine from $5,000 to $10,000. In 1998, New York amended the law again to include prices on wholesale and intermediate goods. Mississippi amended its law in 1994 to classify some violations of the law as felonies and clarify that the emergency need not happen within the state for the law to be invoked. Connecticut amended its price gouging statues in October 2005 to include "any period in which an imminent abnormal market disruption is reasonably anticipated," increased the maximum fine, and specified that the term "seller" included "a supplier, wholesaler, distributor, or retailer."

Changes that narrow the scope of price gouging laws are less common, but they do occur. A year after Utah passed its price gouging law, it was amended to specify that the emergency must occur in Utah for the law to be invoked. In 2010, Connecticut amended its law to provide safe harbor from price gouging prosecution to energy retailers whose margins do not increase. Also in 2010, Georgia amended its law to require the governor to specify in the declaration of emergency just which goods and services will be subjected to price gouging controls.

The Ethics of Price Gouging

Many people feel price gouging is morally wrong. The remarks of newspaper columnists and state legislators provide ready evidence on this topic. Survey research by Daniel Kahneman, Jack Knetsch, and Richard Thaler, published in the *American Economic Review*, further establishes this point: most respondents found price increases during difficult times to be unfair, except in cases in which retailers were only passing along cost increases.

More recent research suggests that these unfairness judgments are driven primarily by emotional responses to the price increases. Careful examination of the ethics of price gouging raises questions for these emotion-driven judgments. The ethical case for limiting price gouging is weaker than it may appear.

Harvard political philosophy professor Michael Sandel opened his 2009 book *Justice: What's the Right Thing to Do?* with the debate over price gouging that followed in the wake of Hurricane Charley. The storm hit Florida in 2004, killing 22 people and causing $11 billion in damages. Sandel said arguments for and against price gouging laws revolved around three ideas: maximizing welfare, respecting freedom, and promoting virtue.

Opponents of price gouging laws focus on welfare and freedom, Sandel said, but neglect considerations of virtue. Sandel cited a September 2004 op-ed by Thomas Sowell to illustrate the welfare point. In it, Sowell said the problem with price gouging laws was that they keep goods and services from being used where they are most needed; people will be better off without price caps. An August 2004 op-ed by columnist Jeff Jacoby provided a quote in support of the freedom argument: "It isn't gouging to charge what the market will bear. It isn't greedy or brazen. It's how goods and services get allocated in a free society."

Both Sowell and Jacoby noted the emotion behind price gouging laws, but dismissed the relevance of emotion for deciding public policy. Sandel suggested that emotion plays a more significant role:

> Much public support for price-gouging laws comes from something more visceral than welfare or freedom. People are outraged at "vultures" who prey on the desperation of others and want them punished — not rewarded with windfall profits. ... [This] outrage is more than mindless anger. It gestures at a moral argument worth taking seriously. Outrage is the special kind of anger you feel when

> you believe that people are getting things they don't deserve. Outrage of this kind is anger at injustice.

Sandel characterizes the virtue argument for price gouging laws as follows:

> Greed is a vice, a bad way of being, especially when it makes people oblivious to the suffering of others. More than a personal vice, it is at odds with civic virtue. In times of trouble, a good society pulls together. Rather than press for maximum advantage, people look out for one another. A society in which people exploit their neighbors for financial gain in times of crisis is not a good society. Excessive greed is therefore a vice that a good society should discourage if it can. Price-gouging laws cannot banish greed, but they can at least restrain its most brazen expression, and signal society's disapproval of it. By punishing greedy behavior rather than rewarding it, society affirms the civic virtue of shared sacrifice for the common good.

Sandel's summary of the virtue argument is revealing both for what it includes and for what it leaves out. He not only acknowledged the role of emotion in motivating price gouging laws, in his view the anger and outrage toward price gouging plays a special role in revealing the morality of the anti–price gouging position.

Sandel's virtue argument does not justify itself in terms of results. The role of the law is to affirm "the civic virtue of shared sacrifice for the common good." No emphasis is put into examining whether affirming civic virtue in this way has been effective in inspiring shared sacrifice or promoting the common good.

Defenders of price gouging laws sometimes concede the material benefits of allowing merchants freedom to set their own prices, even during emergencies, but they still favor the laws in order to stand on the side of virtue. Yet the question of which side is the side of virtue is not so simple. Emergencies and natural disasters are by definition periods of threat, suffering, and sacrifice. If it is admitted that giving merchants the freedom to pick their own prices does a better job than alternative ways of getting goods and services to where they are needed, then interference with that pricing freedom raises serious questions. Interference harms precisely those persons who have been already harmed by the disaster, a result that suggests neither shared sacrifice nor promotion of a common good.

University of San Diego philosophy professor Matt Zwolinski made this point in a 2008 paper examining the ethics of price gouging. His full analysis is more subtle, challenging price gouging ethics on both fairness and consequentialist grounds. If it is true that emergencies are times that a society ought to exercise special care for those members of society in harm's way, then, Zwolinski argues, it is at odds with fairness to place a particularized obligation to sacrifice on a discrete segment of society, namely merchants. Addressing the particular hardships faced by the poor during emergencies, Zwolinski said, is a task better left to government agencies or charities.

Zwolinski added that a predictable consequence of price gouging laws is that some merchants, finding their ability to recover costs compromised, will decide not to sell at all rather than to sell at a loss. Merchants will lose the opportunity to profit and consumers will lose the opportunity to decide for themselves whether the good or service would have been worth the higher price. The possibility of merchants shutting down rather than operating is more than academic speculation. The South Carolina attorney general's office found that during price spikes following Hurricanes Gustav and Ike, some "station owners reported that to avoid bad publicity they simply shut their doors instead of purchasing gasoline at elevated prices."

The South Carolina report on price gouging also indicated that some retail stations went to extraordinary lengths to secure supplies during the emergency even though they were uncertain as to whether they would recover their costs. Zwolinski argued that while such efforts may be laudable, merchants are not under an ethical obligation to do so. In fact, merchants face no ethical obligation to remain open during emergencies, even though closing may contribute to hardships among some potential consumers. And if merchants may ethically close, Zwolinski pointed out, it can hardly be unethical for merchants to remain open but offer goods at a higher-than-usual price. By remaining open even with high prices, the merchant is providing potentially helpful opportunities for consumers in need.

Price Gouging Laws as Public Policy

If the ethical case against price gouging is weak, perhaps there are alternative justifications for the policy. True, many people feel that price increases during emergencies are unfair, but policy analysis requires more than a survey of public sentiment. Proposed laws ought to be examined for their consistency with the proper role and scope of government activity, for the danger that popular programs may erode minority rights, and for the effectiveness of the proposed law in achieving the goals announced. Yet examination of legislative records and newspaper accounts for several states with price gouging laws reveals little in the way of detailed policy analysis.

As previously noted, New York passed the nation's first price gouging law in response to sharp increases in home heating oil costs during the winter of 1978–1979. Newspaper accounts suggest the bill was motivated by a desire to protect consumers. To policymakers it simply appeared wrong to hike prices on consumers undergoing weather-related hardships, and the law sought to protect consumers from such prices. The apparent simplicity of both the law's goals and the approach advocated may have insulated the proposal from thorough policy analysis.

Texas passed its price gouging legislation in 1995, in the form of a few lines in a "tort reform" bill that proposed substantial changes to the state's Deceptive Trade Practices Act. Though the tort reform debate captured both headlines and legislator attention, little notice was given to the section that declared it a "false, misleading, or deceptive act or practice" to sell "fuel, food, medicine, or another necessity at an exorbitant or excessive price" during an emergency declared by the governor.

South Carolina was one of seven states that passed anti–price gouging laws in late 2001 or 2002, primarily in response to reports of price gouging after the September 11, 2001 terrorist attacks. Among many other things, the South Carolina Homeland Security Act of 2002 imposed penalties of up to $1,000 and as many as 30 days in prison for charging "an unconscionable price" for 30 days after a declaration of emergency by the president or governor, or for 15 days after the attorney general issues a notice of "abnormal disruption of the market." Most of the public debate over the Homeland Security Act concerned the expansion of the state's law enforcement authority; as in Texas, the price gouging provisions were a barely discussed part of a much larger bill.

When price gouging legislation reached the floor of the Utah State Senate in 2005, bill sponsor Patrice Arent cited price gouging reports from Florida as motivation, said a majority of states had price gouging laws, and expressed a desire to provide such protection to Utah consumers. Discussions of the bill revealed that the state legislators were aware of the potential for the price controls to interfere with both ordinary business practices and the possible extraordinary efforts businesses may undertake during emergencies. Arent responded that the legislation included accommodations to address concerns of Utah businesses to avoid interfering with such efforts.

Utah had faced just two declared emergencies in the previous 15 years and a single episode of an extreme price for tree removal was mentioned by Arent. Had a formal cost-benefit analysis of the Utah law been conducted, both the costs and benefits would have been minimal. The Utah public was not calling for such protection and lobbyists did not pursue it. Rather, Arent advocated for the bill on the grounds that it would be good for the state to protect consumers from price gouging, and on the grounds that other states were already doing it.

Consequences of Price Gouging Law

Economic analysis of the effects of price gouging laws reveals concerns on both the demand and supply sides of the market. As already noted, price constraints will discourage conservation of goods at exactly the time they are in especially high demand. Simultaneously, price caps discourage extraordinary efforts to bring goods in high demand into the affected area. As Sowell explained, price gouging laws keep goods from being used where they are most needed. It is a result not intended by state legislators, but completely predictable.

In a 2007 *Journal of Competition Law and Economics* paper, David Montgomery, Robert Baron, and Mary Weisskopf present a thorough examination of the effects of price gouging laws. Their assessment of a proposed national price gouging law concluded a national law would have increased total economic losses during Hurricanes Katrina and Rita by nearly $2 billion, mostly from interference with incentives to bring goods and services to areas where they are most needed. In addition, they found that a national price gouging law would have left more of the economic burden of the storms on the states most directly hit, Louisiana and Mississippi, while moderating the economic consequences for the rest of the nation.

This damage-concentrating effect of price gouging laws is especially troubling, but it is a predictable result of suppressing price increases. Higher prices motivate a supply response: wholesalers divert supplies headed for neighboring markets into areas of suddenly higher prices, and the effect is that supplies in neighboring areas are reduced and prices rise a bit in response. As supplies are diverted toward the disaster-struck region, the harms suffered in the area are diminished a degree. Yes, consumers in disaster-struck areas would rather not pay four times the usual price for ice or 30 percent more for gasoline, but they generally would be better off having the opportunity to do so rather than having no opportunity to buy ice or gas at all.

There are further unintended consequences. It can be easier for large retailers to mobilize a response to a localized disaster than for smaller merchants. A nationwide chain can divert shipments intended for its stores in other areas and even move merchandise from other stores to resupply stores in the affected area. These options explain in part why some large retailers are able to limit price increases during declared emergencies. A small mom-and-pop store or even a regional chain in an affected area will have fewer low-cost resupply options available. The result? Price gouging laws are more burdensome for small retailers than for nationwide chains.

Helping Consumers?

It may be objected that while price gouging laws are price controls, they are price controls limited in scope and duration, and hence unlikely to cause significant harm. In addition, states' attorneys general seem somewhat restrained in their application of the laws. At least it is the case that state attorneys general receive thousands of consumer price complaints each year, but relatively few complaints lead to investigations and fewer still yield settlements or lawsuits. Many state laws make allowances for retailers to pass along higher wholesale costs, at least so long as the retailer's profit margin does not increase. In addition, some large chain retailers would pursue a policy of no price increases for relevant consumer goods during emergencies, with or without a law. In such cases, price gouging laws may present little added burden, at least for large retailers, but also little benefit to consumers. Perhaps other policies would be better targets for reform.

Price gouging laws remain problematic. First, it is far from clear that the application of current laws causes little economic harm. Relatively little economic research has examined the effects of price gouging laws on businesses or consumers. However, Montgomery, Baron, and Weisskopf's systematic estimate of the potential effects of a national price gouging law did find that such a law would have substantially increased the damages from disasters like Hurricanes Katrina and Rita. In addition, because the law would hamper the price signals that motivate supply responses from outside the affected area, most of this addition harm would be concentrated in the states directly hit by the storms.

Second, it seems difficult to pin down a clear description of price gouging. State laws frequently employ imprecise terms such as "unconscionable," "exorbitant," or "unreasonably excessive," and provide few specific criteria to identify when a price fits those descriptions. Even in states that specifically permit retailers to pass along cost increases, not all cost increases are treated equally. Merchants are then left unsure as to how much prices can increase under the law. Weigle's and other Knoxville-area gasoline retailers were surely aware of Tennessee's law against charging a price "grossly in excess of a price generally charged" immediately prior to the emergency, except to the extent a merchant is passing along increased costs; apparently the Tennessee attorney general and the retailers had differing views on what constituted increased costs. States that fail to specify when price increases violate the law fail to provide a well-tailored law to protect consumers. Instead, vague price gouging laws add to the uncertainty faced by merchants operating in disaster-affected areas.

Third, while price gouging laws may be somewhat limited in scope and duration, those limits are being eroded. Price gouging laws are increasingly being applied to a broader sets of goods and services, penalties are becoming harsher, the laws are invoked more frequently, and they are in force for longer periods of time. No state with a price gouging law has repealed it, and states lacking a price gouging law continue to face legislative proposals to enact such laws. Federal price gouging legislation has been proposed repeatedly over the past several Congresses.

Finally, on moral grounds not well captured by economic analysis, the nature of price gouging laws is to hinder actions that would tend to aid persons in desperate conditions. Capped prices tend to discourage conservation of needed goods or services. One family, evacuated from its home, may reserve two hotel rooms at a capped rate when they would have taken one at higher prices; late-arriving evacuees will find fewer rooms available. Similarly, capped prices tend to discourage extraordinary efforts to resupply an area with vitally needed goods or services. Some shop owners in affected areas will shut down rather than operate during times of stress, effectively taking goods off the market rather than making them available to consumers. Fewer individuals outside of the affected areas will risk their time and money bringing ice, electric generators, or other goods into storm-ravaged areas if they risk arrest and fines for charging "unconscionable prices."

Conclusion

If public policy ought especially to protect persons during periods of emergency — and that is the claim of some advocates of price gouging laws — then price gouging laws should be repealed if it is found that they lead to more harm than good for such persons. Advocates of price gouging laws recognize the strong emotions that motivate anti–price gouging attitudes and claim this emotion highlights the moral seriousness of price increases during emergencies. But a sustained examination of the ethics of price gouging finds the moral case against price gouging to be weak. When the consequences of anti-gouging regulations are considered instead of just the intentions of their advocates, moral considerations likely weigh against, rather than for, price gouging laws.

The straightforward economic analysis of Montgomery, Baron, and Weisskopf concluded that a nationwide price gouging law would exacerbate the effects of natural disasters and tend to concentrate the harm in the locations most directly hit by the disasters. Or, to frame this point differently, in the absence of price gouging laws, the natural workings of the price system would be to reduce the overall harm resulting from a disaster and share the harm remaining across a larger part of the population. Price gouging laws hinder this natural response.

The irony here for the virtue argument described by Sandel is acute. It is the special claim of the virtue argument that it intends to promote a civic virtue of shared sacrifice for the common good, yet price gouging laws are destructive on both points. Because price gouging laws interfere with price signals, resources from outside of the disaster-affected area are not so readily mobilized. Rather than promoting a shared sacrifice in response to a disaster, economic damage tends to be more localized. A further result of interfering with price signals is that fewer resources get to where they are most needed, and therefore the common good is harmed rather than promoted.

If the virtue argument for price gouging laws fails, we are left with welfare and freedom considerations. Here the case against price gouging laws is substantial. Price controls interfere with the ability of merchants and consumers to settle freely on the prices at which they will trade. Price controls also reduce economic welfare: by limiting price increases in areas harmed by emergencies, the laws discourage conservation of goods and services precisely when they are needed most and discourage extraordinary efforts to bring goods in high demand into the affected area.

Laws proscribing price gouging intend to enforce a moral view that says it is wrong to take advantage of another's pain for one's own gain. The intention may be laudable, but the results of the laws clearly are not. Merchants and consumers would be better off without price gouging laws. R

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